

106 S.Ct. 2841, 92 L.Ed.2d 140 (1986), although sodomy was not supported by tradition. On this point, the majority opinion opined that “[H]istory and tradition are the starting point but not in all cases the ending point of the substantive due process inquiry.”¹⁷⁾

VII. Conclusion

Reform of Korean family law was marked by struggles between the Constitutional principles and tradition. The movement to conform family law to the Constitution was retarded by the resistance of conservative groups, whose main argument was that family law ought to be rooted in tradition. But tradition alone cannot be a defense for an otherwise unconstitutional law. In the reform process, the Korean Constitutional Court played a significant role in upholding the primacy of the Constitution, as evident in the decisions regarding the common surname marriage ban and the *hoju* system.

17) 123 S.Ct. 2480.

Securities Enforcement in Pre-1997 South Korea: An Analysis of the Korea Securities and Exchange Commission (KSEC)

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Abstract

This paper focuses on the role and delegated authority of the Korea Securities and Exchange Commission (KSEC) regarding securities regulation and enforcement during the period up to the 1997 Asian financial crisis period. Securities regulation, at this time in Korea, was generally administered under the combined auspices of several government agencies. These agencies included the KSEC, the Securities Supervisory Board (SSB), Ministry of Finance and Economy (MOFE), Korean Securities Depository (KSD) and the Korean Stock Exchange (KSE). The Korean SEC, specifically, acted under the conferred authority of the Securities and Exchange Act (SEA), enacted in 1962.

Since Korea's recent democratic emergence in 1945, the government has incorporated facets of American, Japanese, and German law into its own legal system. For this reason, it is of interest to investigate the KSEC, acting under the provisions set forth in the SEA, with some comparison to its American counterpart, the U.S. Securities and Exchange Commission (SEC). To accomplish this, a compilation of primary government sources, related articles, and scholarly texts will be used.

To date, very little work exists regarding the KSEC and its role in the Korean securities market and economy during the pre-1997 period. Because of this omission within the current academic literature, the current topic has been undertaken.

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Introduction

This paper focuses on the role and delegated authority of the Korea Securities and Exchange Commission (KSEC) regarding securities regulation and enforcement during the period up to the 1997 Asian financial crisis period. Securities regulation, at this time in Korea, was generally administered under the combined auspices of several government agencies. These agencies included the KSEC, the Securities Supervisory Board (SSB), Ministry of Finance and Economy (MOFE), Korean Securities Depository (KSD)¹⁾ and the Korean Stock Exchange (KSE).²⁾ The Korean SEC, specifically, acted under the conferred authority of the Securities and Exchange Act (SEA), enacted in 1962.³⁾

Since Korea's recent democratic emergence in 1945,⁴⁾ the government has

1) The KSD possesses many similar facets to an American depository receipt institution, though with a slightly wider scope. The KSD also collects securities transactions taxes and settles transactions reached at the KSE.

2) Following the 1997 Asian financial crisis, the Financial Supervisory Commission (FSC) replaced the KSEC, while the Financial Supervisory Service (FSS) replaced the Securities Supervisory Board (SSB).

Specifically, the Financial Supervisory Commission (FSC) was established as the primary banking regulator in Korea on April 1, 1998. See FSC website, at <http://www.fsc.go.kr/eng/about/index.asp>. Under the new system, all financial institutions are subject to the supervision of the FSC and its executive arm, the Financial Supervisory Service (FSS). In addition, the Securities & Futures Commission (SFC) was set up under the FSC to oversee securities and futures markets. *Id.* The FSC's principal objective is to (i) investigate market abuses (such as insider trading and market manipulation in the securities and futures markets); (ii) to oversee accounting standards; and (iii) conduct audit reviews. *Id.*

The FSS was established under the Act on the Establishment of Financial Supervisory Organizations on January 2, 1999. See FSS website, at <http://english.fss.or.kr/fsseng/eabu/int/est.jsp>. The FSS was created by integrating the four existing supervisory bodies (i.e., the Securities Supervisory Board (SSB), Banking Supervisory Authority, Insurance Supervisory Board and the Non-bank Supervisory Authority) under the auspices of a single regulatory body. *Id.* The major functions of the FSS include the supervision, examination, investigation of and enforcement relating to financial institutions as well as other matters delegated by the FSC and SFC. *Id.*

3) The Securities and Exchange Act's (SEA) objective is to guarantee fair transactions in issuing and trading securities, to facilitate securities trading, to protect investors and to promote development in Korea's economy. The SEA focuses on investor protection, timely disclosure, issuer registration, public offering, secondary market distributions, tender offers, insider trading and regulating securities businesses and investment advisors. See Securities and Exchange Act available at <http://www.ksda.or.kr/english/dataroom/law.cfm>

4) Subsequent to the Japanese occupation of the Korean peninsula (1910-1945), American forces instilled the democratically-elected presidency of Syngman Rhee (1945-1960). During the Japanese colonization period, Rhee was a visible leader for the Korean independence movement, but was later ousted in a *coup d'etat* led by General Park Chung Hee (1961-1979).

incorporated facets of American, Japanese, and German law into its own legal system. For this reason, it is of interest to investigate the KSEC, acting under the provisions set forth in the SEA, with some comparison to its American counterpart, the U.S. Securities and Exchange Commission (SEC). To accomplish this, a compilation of primary government sources, related articles, and scholarly texts will be used.

To date, very little work exists regarding the KSEC and its role in the Korean securities market and economy during the pre-1997 period. Because of this omission within the current academic literature, the current topic has been undertaken.

Methodology

This paper is composed of four parts. First, the introduction covers the Korean economy, the role of the *chaebol*,⁵⁾ and general structure of the Korean capital market system. Second, an overview of the KSEC will be conducted, including its history, relationship with the KSE, and enforcement powers. Third, the KSEC and SEC are compared, with an emphasis on enforcement authority, legislative acts, and use of divisional branches. Fourth, and finally, concluding remarks are offered, including suggestions as to why the KSEC was not an effective securities regulatory body relative to the U.S. case. This paper concludes by arguing that the increased use and potential for suspect securities transactions by global investors, up to 1997, necessitated a greater delegation of legislative authority to the KSEC through amendments to the SEA, which did not occur. Specifically, explicit legislative authority to compel court assistance for injunctive relief and criminal proceedings to ensure efficient and effective securities enforcement by the KSEC should have been provided, but was never granted. This legislative omission along with the KSEC's lack of independence was in strong contrast to the U.S. case, which ultimately led to the KSEC's demise following the 1997-98 Asian financial crisis.

5) In basic terms, *chaebol* can be interpreted as "conglomerate". Two Chinese characters are used to describe the term *chaebol*. The first character translates into "wealth" or "finance", while the second character is defined as "clique". The Japanese pronunciation of these two characters is *zaibatsu*, which is used to describe giant industrial groups in Pre-War Japan.

For purposes of clarity, this paper focuses primarily on the Korean Securities and Exchange Act (SEA) relating to the KSEC rather than broadly surveying the array of possible other relevant laws embedded in the Korean legal system, such as the Korean Commercial, Civil, and Criminal Codes. Moreover, this paper does not argue that the 1997 Asian financial crisis directly triggered the KSEC's demise and eventual replacement of the KSEC by the Financial Supervisory Commission (FSC).⁶⁾ Rather the 1997 Asian financial crisis is referred to as a relevant event and time period only in that its profound effect upon the economy caused many Korean government officials to dramatically rethink and therefore re-legislate certain relevant securities regulations related to securities markets, securities market players, and securities market regulators relating to the KSEC at that time.

I. Introduction

A. Korean Economy, 1960-1997

Korea's rapid economic growth period began in the early 1960's, which marked the beginning of President Park Chung Hee's⁷⁾ government, and his subsequent economic-driven Five-Year Plans (FYPs). General Park's FYPs represented national economic plans for increased macroeconomic growth, initiated in 1962.⁸⁾ At the conclusion of each FYP came the reactivation of subsequent FYPs, with slightly refocused economic themes and goals. During the 1960s, for instance, import substitution for heavy and chemical industry represented Korea's economic

6) The Financial Supervisory Commission (FSC) was created by the Act for the Establishment of Financial Supervisory Organizations (AEFSO) enacted on Dec. 31, 1997. The FSC was formed with the purpose to integrate responsibilities for financial supervision into one organization. See Laws and Decrees related to the Financial Supervisory Commission available at <http://www.fsc.go.kr/Eng/decrees/>

7) For the purposes of this paper, names will be listed last name first, which reflects Korea's (and most of Asia's) focus on tribal lineage demarcation.

8) President Park Chung Hee played a major role in Korea's robust economic growth from the 1960s onwards. President Park made Korea's economy competitive in the world market by maintaining outward-looking export promotion and setting foreign exchange rates. Other factors such as large savings and investment rates, and accomplished hardworking people also contributed to Korea's swift economic growth. See Uk Heo and Sunwoong Kim, *FINANCIAL CRISIS IN SOUTH KOREA: Failure of the Government-Led Development Paradigm* 494 (Asian Survey VOL XI No.3 May/June 2000) [hereinafter Heo and Kim].

strategy.⁹⁾ In the 1970s, a gradual refocus towards export orientation of more capital-intensive goods evolved.¹⁰⁾

The results of President Park's FYPs were impressive. For example, Korea's average annual growth rate of GNP per capita from 1965 to 1986 was 6.7 percent.¹¹⁾ Korea's rate of growth also compared favorably to 4.3 percent and 1.6 percent for Japan and the United States, respectively, during the same period.¹²⁾

As part of the government's import-substitution and export promotion practices, high tariff barriers were also erected to protect Korea's infant industries.¹³⁾ In addition, much-needed imports such as raw materials were partially subsidized by the state. Other imports that competed with domestic firms were given substantial import duties in the range of 50 percent. Exports by key industries were also aided by various export promotion mechanisms. Further, Korean exports with their relatively low-cost labor undersold competitors and penetrated new markets. Korea was also assisted by the ever-increasing value of the Japanese yen on foreign exchange markets.¹⁴⁾ The combination of these two factors allowed Korea to maintain its macroeconomic focus.

B. The Role of the Chaebol

A "chaebol" is defined as a business group consisting of large companies owned and managed by family members or relatives in many diversified business sectors.¹⁵⁾

9) The government's policy was to provide protection to local industries by restricting imports until local producers were able to meet or exceed the quality of the imported good. In addition, the government established quotas and imposed other explicit and implicit restrictions, such as trading areas and varying levels of access to credit.

10) The Korean government established export targets for targeted Korean firms during the 1960s and 1970s. Successful exports received presidential medals and below-market rate loans. Moreover, monthly trade promotion meetings were attended by senior government officials and private enterprise leaders. Thus, a continuous and close relationship existed between government and leaders of private industries. See Heo and Kim at 496.

11) Alan S. Gutterman, *Japan and Korea: Contrasts and Comparisons in Regulatory Policies of Cooperative Growth Economies*, 8 INT'L TAX & BUS. LAW. 267, 268 (1991).

12) *Id.*

13) In a 1982 survey by *Business Korea*, international businesspeople rated Japan as the world's most closed economy, while Korea also placed highly in the same survey.

14) Bank of Korea, *Chosa Tonggye Wolbo*, Monthly Bulletin, No. 9, (Seoul, 1989), p. 110.

15) Sangjin Yoo and Sang M. Lee, *Management Style and Practice of Korean Chaebols*, CALIFORNIA MANAGEMENT REVIEW, 97 (Summer, 1987).

An alternative definition defines *chaebol* as “a closely held, integrated, yet diversified corporate entity that produces a wide array of product lines for global consumption”.¹⁶⁾ The largest conglomerates historically possessed strong market presence and concentration. For example, by 1979, the five largest *chaebol* accounted for at least one-fifth of total manufacturing output, and 8.1 percent of Korea’s 1978 GDP.¹⁷⁾

Several trademark features existed for the *chaebol*.¹⁸⁾ First, *chaebol* corporate expansion typically occurred horizontally.¹⁹⁾ That is, Korean conglomerates in one industry sought to expand to related industry. Second, a close business-state relationship played an instrumental role in the *chaebol* expansion process.²⁰⁾ Third, the largest *chaebol* possessed a dominant market share in many industries, especially in manufacturing and chemicals.²¹⁾ Fourth, corporate profits were used for reinvestment and expansion efforts.

The *chaebol*, state, and financial intermediaries represented the crux of Korea’s economic growth. It was large conglomerates, like the *chaebol*, that were listed and possessed membership rights to the Korean Stock Exchange (KSE). Once the state targeted a *chaebol* for a given industry, the Korean government²²⁾ protected that *chaebol* by inhibiting other competitors from entering the same market. Thus the performance of the KSE and *chaebol* were contingent upon each other because of the highly interwoven business-government structure of the Korean economy.

16) RICHARD M. STEERS, YOO KEUN SHIN, AND GERARDO R. UNGSON, *THE CHAEBOL: KOREA’S NEW INDUSTRIAL MIGHT* 35 (1989).

17) LEROY P. JONES, *JAE-BUL AND THE CONCENTRATION OF ECONOMIC POWER IN KOREAN DEVELOPMENT: ISSUES, EVIDENCE AND ALTERNATIVES*, Consultant Paper Series No. 12, Preliminary Draft, 21 (July 1980).

18) The restructuring of *chaebols* was an important point emphasized by the IMF during Korea’s post-1997 financial crisis recovery period. President Kim Dae Jung’s government imposed five specific rules on *chaebol* reform, which included: consolidation of business to core competent areas, capital structure enhancement, discarding cross debt guarantee, improved management transparency, and an increase in management accountability. See Phil-Sang Lee, *Economic Crisis and Chaebol Reform in Korea* 12 (Discussion Paper No.14 Discussion Paper Series, APEC Study Center, Columbia University, Oct 2000)

19) ALICE H. AMSDEN, *ASIA’S NEXT GIANT: SOUTH KOREA AND LATE INDUSTRIALIZATION* 125 (1989).

20) KARL J. FIELDS, *ENTERPRISE AND THE STATE IN KOREA AND TAIWAN* 34 (1995).

21) See JONES, *supra* note 18, at 35.

22) Specifically, such agencies included the Ministry of Finance and Bank of Korea (BOK).

The need to procure government funding represented a fundamental element of Korean conglomerate growth. Favored conglomerates with government-backed funding could therefore engage in long-term investment strategies.²³⁾ Consequently, large conglomerates looked less towards securities offerings, i.e., stocks, bonds, or other long-term debt issuances, for investment or operating funds, as compared to the U.S. or U.K.

C. Capital Market Actors and Securities Law

The Korean Stock Exchange began in 1956 to provide a forum for securities trading under the Korean Securities and Exchange Act (SEA).²⁴⁾²⁵⁾ The KSE is a non-profit organization which operates under a membership system stipulated by the Charter of the KSE.²⁶⁾ As of August 1996, thirty-six securities houses were members, of which three were non-Korean affiliates.²⁷⁾ The KSE also engaged in sub-functions like listing, trade matching, corporate disclosure, surveillance and member administration, and the auctioning of unlisted securities.²⁸⁾ The basic function of the KSE was essentially the operation of the securities market, including the securities

23) Korea’s former presidents typically employed banks and bureaucracies to support select companies with which they had close connections. This close relationship between the Korean government and *chaebols* was maintained for the purpose of excerpting money and compensating political allies. See James C. Schopf *An Explanation for the End of Political Bank Robbery in the Republic of Korea: The T+T Model* 693 (Asian Survey VOL 41 No.5 Sep-Oct, 2001)

24) The Korean Securities and Exchange Act was enacted in 1962 to promote the wide and orderly circulation of securities through fair issuances and trade, as well as to protect investors.

25) In-Kie Hong, *Securities Regulation in Korea and Regulations on Foreign Investment*, 10 COLUM. J. ASIAN L. 157 (publication page references not available for this document) (1996). Mr. Hong was the acting Chairman and Chief Executive Officer of the Korean Stock Exchange, and former Director General of the Ministry of Finance (1970-73).

26) Art. 10 of the KSE Charter limits membership to those securities companies receiving approval to establish an office under article 28 of the SEA. Articles 11 to 16 stipulate further requirements, such as amount of capital investment, dues, deposit funds, disclosures, and documentation. Articles 19 to 21-2 deal with membership application, membership fees, and related items, while articles 28 to 29 detail disciplinary measures. Also of particular relevance is article 39 that provides for inspection of members suspected of engaging in aberrant trading. Disciplinary measures include trade suspension, fine imposition, and request of employee disciplinary action (for violation of law, falsification of documents, and obstruction of inspection).

27) See Hong, *supra* note 25, at 3.

28) Id.

index futures market.

The KSE also possessed some enforcement authority to ensure fairness of securities transactions.²⁹⁾ For example, the Exchange could suspend trading or expel a member for failure to make a payment. In addition, the KSE could also request members to take disciplinary measures against officers or employees under their control.³⁰⁾ Moreover, because of the KSE's rather lengthy membership requirements, the Exchange had few foreign corporate or securities entities. However, President Kim Young Sam³¹⁾ made internationalization of the Korean economy a major political issue. President Kim's administration had consequently taken explicit action to lower barriers aimed at foreign entrants to the Korean securities market.³²⁾

Most actors in the securities industry operated under the auspices of the Securities and Exchange Act (SEA). The scope of the SEA³³⁾ included the general functioning of securities-related organizations. Specifically, the SEA governed the issuance and trading of securities, the supervision of the securities market, and the enforcement of SEA provisions.³⁴⁾ The SEA also supervised matters such as

29) The Korean Securities Exchange Act was modified in December 2000. Audit Committees were included in the new rules. Large public companies with total assets exceeding two trillion won are requested to include audit committees. The committee must have a minimum of three outside directors or above two-thirds of the committee members must consist of outside directors. As a result, the Audit Committee is relatively new in Korea and only a few big companies have them. This is in stark contrast to the US where most companies have auditing committees generally trusted by the public, which were first established as early as in the 1940s. See Jong-Hag Choi, Kyu-An Jeon, and Jong-Il Park, *The role of such Audit Committees in Decreasing Earnings Management: Korean evidence* 38-39 (Int. J. Accounting, Auditing and Performance Evaluation Vol.1, No.1, 2004)

30) See Hong, *supra* note 25, at 3

31) Kim Young Sam was elected as President of South Korea in the 1992 election.

32) The opening of the Korean economy also correlates with Korea's recent status as an OECD member country. As part of the OECD's membership requirements, Korea was forced to demonstrate, in good faith, steps to lower barriers to foreign entry. Korea joined the OECD in 1996.

33) The Korean Ministry of Finance and Economy (MOFE) allowed electronic securities transactions through amending the Securities and Exchange Act in 1997. In 1999 capital requirements for a financial broker were substantially decreased from 10 billion won to 3 billion won. The Financial Supervisory Commission (FSC) simultaneously founded detailed requirements for getting a license of a securities company. These financial market policies opened new ways of securities trading in Korea. The government also encouraged the development of information technology and infrastructure through indirect policies involving the internet infrastructure. See Jinho Byun, *Online Securities Trading in Korea: Developments and Trends*, APEC Working Group on Electronic Financial Systems, Japan, 2002.

34) See Hong, *supra* note 25, at 1.

corporate disclosure, proxy solicitation, acquisition of treasury stock, and restrictions on mutual ownership between companies.³⁵⁾

The SEA also provided the legal foundation for other actors in the securities field. Besides securities firms, for example, the SEA was the predominant legal instrument used by the Korean Securities and Exchange Commission (KSEC), the Securities Supervisory Board (SSB),³⁶⁾ the Korean Stock Exchange (KSE), and the Korea Securities Depository (KSD).³⁷⁾ Further, SEA enforcement provisions governed fair trading, fraud and price manipulation, insider trading, and penalties for such respective violations. In essence, the SEA was a "special law"³⁸⁾, and thus its provisions overrode other laws on securities matters.³⁹⁾

The SEA Enforcement Decree⁴⁰⁾ supplemented the SEA with detailed regulations. However, because the KSEC had been better situated to realize the ever-changing techniques and tactics used in the securities industries, the Commission handled many aspects of such enforcement regulation under powers delegated to it by the SEA.⁴¹⁾

35) *See id.*

36) The Securities Supervisory Board is the executive organ of the Korean Securities and Exchange Commission.

37) See Hong, *supra* note 25, at 1.

38) In Korean jurisprudence, a "special law" is a law which applies only under specific circumstances to people, places, and/or events. A special law contrasts with a "basic law" which applies to persons, places, events, etc., without any specific limitations. Application of a special law takes precedence over basic law. In civil law countries like Korea, the Civil Code is a basic law that applies to wide-ranging situations like divorce proceedings and property disputes. On the other hand, the Commercial Code is a law dealing with commercial matters such as corporate management and transactions. The Commercial Code, a special law vis-a-vis the Civil Code, takes precedence over the Civil Code. Also, the SEA pre-empts the Commercial Code on securities matters.

39) In addition to the SEA, other laws regulating various aspects of the securities market and industry exist. Such laws include the Commercial Code (the legal foundation for the SEA), the Capital Market Promotion Act (supporting the growth of the securities industry), the Securities Investment Trust Act, the Law on the External Auditing of Stock Corporations, the Act on the Registration of Public and Corporate Bonds, the Act on the Trust of Collateralized Corporate Bonds, the Monopoly Regulation and Fair Trade Act, and the Securities Transaction Tax Act.

40) Presidential Decree No. 8436, Feb. 9, 1977 (as amended Apr. 30, 1994) {hereinafter Enforcement Decree}.

41) Young Moo Shin, *Regulations of Disclosure and Insider Trading in Korea: A Comparative Analysis*, in *BUSINESS LAWS IN KOREA: INVESTMENT, TAXATION AND INDUSTRIAL PROPERTY* 540, 545-546 (Chan-Jin Kim, 1982).

Table 1 Key Statistics of the Korea Stock Exchange

(Unit: U.S.\$ billion, points)

Year	No.of Companies	Market Capitalization	Trading Value	KOSPI	Trading Value of Bonds
1991	686	96	82	610.92	2.7
1992	688	107	115	678.44	0.7
1993	693	139	210	866.18	-
1994	699	191	291	1,027.37	1.5
1995	721	184	187	1,016.77	2.1

Source: Securities Supervisory Board, *Securities Market Regulation in Korea* (1996).

II. The Korea Securities and Exchange Commission (KSEC)

A. History, Organization and Judicial Enforcement

The KSEC was an administrative committee composed of nine commissioners,⁴²⁾ formed in 1976 under revised SEA provisions.⁴³⁾ The Korea Securities and Exchange Commission⁴⁴⁾ generally oversaw matters related to the trading and issuance of securities and securities-related organizations. The KSEC was primarily composed of non-government officials, and lacked judicial or quasi-judicial authority. Instead, most enforcement proceedings were handled by the Securities Supervisory Board,

42) Of the KSEC's nine commissioners, the president of the Bank of Korea (BOK), the Chairman of the KSE, and the Vice-Minister of the Ministry of Finance and Economy (MOFE) maintain automatic positions. The remaining six seats, three standing and three non-standing, are chosen by the President from among MOFE recommended candidates.

43) The Securities and Exchange Act of Dec. 22, 1976, Law No. 2920 (as amended by Law No. 4701, Jan. 5, 1994) (C. CIV art. 18, 20 (Kr.) {hereinafter SEA}).

44) The FSC is responsible for the promulgation and amendment of financial supervisory rules and regulations. It approves and grants permission for the business of financial institutions relating to their operations and for the deliberation and resolution of agenda with respect to any inspections, examinations and sanctions on financial institutions, etc. See The Act for the Establishment of Financial Supervisory Organizations available at <http://www.fsc.go.kr/eng/decrees/index.asp>

with some ancillary duties left to the KSE.⁴⁵⁾

The Korean SEC, along with the KSE and SSB, was also under the greater authority of the Ministry of Finance and Economy (MOFE). Because the KSEC was not an independent agency, any action by the Commission, including all adopted resolutions,⁴⁶⁾ were required to be reported to the MOFE.⁴⁷⁾ Consequently, any KSEC approved resolution found illegal or inappropriate by the MOFE may have been amended, canceled, or suspended.⁴⁸⁾

Regarding specific legislative authority, the Korean SEC, under Article 128 of the SEA, had the authority to investigate anyone suspected of violating any relevant securities laws for the protection of the public interest or investors.⁴⁹⁾ The KSEC could also require a person under investigation to submit reports, documents, or even request a person to appear as a witness.⁵⁰⁾

Table 2 Key Statistics of KSEC Enforcement Activities

(Unit: Cases)

Year	MAJOR VIOLATIONS		MAJOR MEASURES TAKEN	
	Market Manipulation	Insider Trading	Referral to Judicial Authority	Disgorged Profits
1991	6	6	10	8
1992	9	16	25	18
1993	5	6	10	17
1994	19	5	7	6
1995	31	3	13	6
1996	18	4	12	15

Source: Securities Supervisory Board, *Securities Market Regulation in Korea* (1996).

45) Sang-Hyun Song, *Law and Policy of Securities Regulation in Korea*, 4 PAC. RIM L. & POL'Y J. 757, 760 (1995).

46) Resolutions adopted by the KSEC require a two-thirds vote, so long as a quorum of at least two-thirds of the commissioners is satisfied.

47) See Song, supra note 45, at 760.

48) *Id.*

49) *Id.* at 771.

50) See SEA at art. 128(2).

B. Establishment of the Financial Supervisory Commission (FSC)

The Act on the Establishment of Financial Supervisory Organizations was enacted in April 1998 in order to establish an independent financial supervisory organization that would assume the role of leading and monitoring the process of financial restructuring in Korea. This act consolidated all the institutional functions for the supervision of commercial banks, securities companies, insurance companies, and secondary financial institutions. With its inception in April 1998, the Financial Supervisory Commission (FSC) has been leading financial sector reform in the post-1997 period.⁵¹⁾ The FSC abides by the core principles of effective banking supervision as provided in the Basle Agreement as the basis of its operations.⁵²⁾ The Bank Restructuring Unit was also formed within the FSC in April 1998 with the task of coordinating and monitoring the restructuring of banks and the provision of public funds among them.⁵³⁾

The FSC actively led the restructuring effort of the banking sector by requiring banks to submit rehabilitation plans based on fundamental market values such as transparency, efficiency, and profitability. The above Act mandated the FSC⁵⁴⁾ to have all the powers necessary to effectively handle insolvent financial institutions, i.e. to close nonviable institutions and support viable ones according to market

51) The Financial Supervisory Commission (FSC) established in 1998 was created as an independent agency to supervise all financial markets and institutions. Financial institutions were allowed to offer a diverse range of services, disclosure, auditing and accounting practices were improved so published accounts would comply with international standards, and most bans on foreign investment were lifted. As a result the skills and information required to run a financial system were moved from the government to market based institutions making domestic institutions take responsibility for the loans they authorize. See Suk H. Kim, *Effective Financial Market Regulation and Corporate Governance After the Korean Financial Crisis: Lessons from the United States* available at <http://www.kif.re.kr/KMFileDir/nr0109-4.pdf>

52) Yunjon Wang, Hyoungsoo Zang (ed), "Adjustment Reforms in Korea since the Financial Crisis", Korea Institute for International Economic Policy (KIEP) Policy Paper 98-02, KIEP 1998, p.90.

53) See *id.* at 9-10.

54) The Financial Supervisory Commission (FSC) was formed by combining regulatory and oversight functions, which were formerly dispersed among several independent and disconnected organizations. In 1998 a wide financial sector reform took place, in which the short-term goal was the stabilization of the financial sector. The long-term goal was improving the soundness and efficiency of the financial sector under the Financial Supervisory Commission. See Yoon Je Cho *Korea's Financial Restructuring: Steps Taken and Remaining Challenges* available at <http://www.sogang.ac.kr/~yjcho/working%20paper%2099-07.pdf>

principles. Therefore, the banks that fell short of the international standards-based evaluation criteria of the FSC were suspended or closed or in some cases approved only under the condition that they made full efforts to undergo restructuring or M&As before a strict deadline. Hence, the enactment of the Act on the Establishment of Financial Supervisory Organizations served as a cornerstone in the economic reform effort of the post-1997 Korean government as it mandated the restructuring of the financial sector to be led and monitored by a comprehensive and powerful organization run by market-based principles.

This Act was a notable departure from the policy of the pre-1997 Korean republic whereby the government tended to prop up nonviable institutions in an attempt to prevent the negative effects their collapse would have on the market. However, as demonstrated by the 1997 Korean financial crisis, the failure of the government to allow financial institutions to be closed down at appropriate times actually accumulated to fundamentally distort market forces in the financial sector, and thus led to massive inefficiency and structural weakness of the financial market. Therefore, the post-1997 legislation was distinct from that of the pre-1997 period in that it gave the FSC greater authority to close down nonviable financial institutions in the spirit of pursuing international market standards. Closing down banks deemed nonviable by the market marked a distinct and significant shift away from a crony capitalist past towards a more free market oriented future following the 1997 Korean financial crisis.⁵⁵⁾

III. Comparison of the Korea and U.S. Securities and Exchange Commissions

A. The United States Securities and Exchange Commission

The United States Securities and Exchange Commission (SEC) principally

55) Crony capitalism is often referred to as a cause of the 1997 Asian financial crisis. Crony Capitalism can be defined as an economic surrounding where corporations or individuals pay certain government officials to conduct and sustain their business. Corruption may have an effect on the country's capital inflows by making it more liable to change in the expectations of international creditors. See Shang-Jin Wei *Negative Alchemy? Corruption, Composition of Capital Flows and Currency Crisis* available at <http://www.nber.org/~confer/2001/ccef/wei.PDF>

operates as an agency for the elicitation of disclosure for the benefit of investors.⁵⁶⁾ The Commission has a broad charter, which includes oversight into company governance in a mission to insure the fair and efficient exchange of securities transactions for the welfare of all citizens, possessing “quasi-judicial” authority with which to enforce its charter.⁵⁷⁾

The Securities and Exchange Commission operates under the legislative authority of two main statutes, the Securities Act of 1933,⁵⁸⁾ and the Securities and Exchange Act of 1934.⁵⁹⁾ Prior to 1933, securities markets were regulated by an assortment of state laws, along with a system of self-governance by relevant industries.⁶⁰⁾ During that time, for example, laws to protect the individual investor from fraudulent sales of stock, known as “blue sky” laws, were provided under state law.⁶¹⁾

Federal securities regulation, prior to 1933, was stymied for several reasons. First, strong Wall Street opposition⁶²⁾ existed because of a fear that securities regulation would hamper general market efficiency.⁶³⁾ Second, the rapid economic expansion of the 1920’s led to a sentiment of temporary security and status quo mentality, while both small and large investors profited from a bullish stock market.⁶⁴⁾ Third, securities-related actors felt that current internal regulation under the constitution of many exchanges⁶⁵⁾ constituted sufficient regulatory devices, without undue interference.

56) KENNETH LEHN AND ROBERT W. KAMPHUIS, JR., MODERNIZING U.S. SECURITIES REGULATION: ECONOMIC AND LEGAL PERSPECTIVES 16 (1992).

57) *Id.* at 17.

58) 15 U.S.C. § 77a (1988).

59) 15 U.S.C. § 78a (1988).

60) ANNE M. KHADEMIAN, THE SEC AND CAPITAL MARKET REGULATION: THE POLITICS OF EXPERTISE 24 (1992).

61) *Id.* at 25. Moreover, “blue sky” laws were intended to protect the investing public from securities dealers, at that time, who would sell shares of “anything”, including the sky. *Id.*

62) Wall Street opposition was led by the president of the New York Stock Exchange, Richard Whitney, who enlisted the support of groups representing a cross-section of the financial community. In addition, Congress was pressured by a letter-writing campaign orchestrated by Whitney. *See* Khademian, *supra* note 61, at 32-33.

63) *Id.*

64) *Id.*

65) Places like the New York Stock Exchange (NYSE) and the New York Curb Exchange (later named the American Stock Exchange, or AMEX) regulated trade practices by establishing qualifications for membership and some disciplinary measures for non-compliance.

The 1929 stock market crash, however, instilled a sudden urgency for uniform federal securities regulation. Four years later, the 1933 Securities Act was enacted.⁶⁶⁾ In essence, the intent of the 1933 Act was to protect the public from fraudulent practices regarding the purchase and sale of newly issued securities.⁶⁷⁾ Moreover, the 1933 Securities Act⁶⁸⁾ required securities to be registered with the SEC, along with a mandatory prospectus publication prior to the sale of any securities to the general public.⁶⁹⁾ The 1933 Act also provided civil and criminal liability for failure to comply with such provisions.⁷⁰⁾ The SEC was thus given authority to handle civil investigations⁷¹⁾, while other federal authorities, like the U.S. Department of Justice, could be requested to pursue criminal infractions.

The 1934 Securities Exchange Act represented the second major federal securities law. The 1934 Act⁷²⁾ established reporting requirements for specified corporations that offered securities sales to the public.⁷³⁾ Specifically, a corporation falls within this provision if it possesses total assets exceeding US\$1 million and a class of equity securities that is held by more than 500 persons at any year-end, or has a class of securities registered on a stock exchange at any fiscal year-end.⁷⁴⁾ If a corporation meets these conditions, it must abide by the following requirements: 1) filing specified reports with the SEC; 2) disclose material facts in proxy solicitations;

66) The four year lag between the stock market crash and the first major federal securities law reiterates the resistance to such regulation.

67) LARRY G. POINTER AND RICHARD G. SCHROEDER, AN INTRODUCTION TO THE SECURITIES AND EXCHANGE COMMISSION 21 (1986).

68) The Act required registration of securities before public sales. It also required sufficient exposure for the informed analysis of potential investors and strictly banned deceptive written and oral statements by expressly formalizing antifraud provisions. *See* Suk H. Kim *supra* note 52 at 132.

69) *See* Pointer and Schroeder, *supra* note 67.

70) *Id.*

71) EDWARD T. MCCORMICK, UNDERSTANDING THE SECURITIES ACT AND THE S.E.C. 162 (1948).

72) The Securities and Exchange Commission (SEC) was created through the 1934 Securities Exchange Act. The Act gives the SEC expansive control over the securities industry. The SEC has the power to register, regulate and oversee brokerage firms, transfer agents, clearing agencies and US securities self regulatory organizations (SROs) like the New York Stock Exchange. *See* Securities Exchange Act of 1934 *available at* <http://www.sec.gov/about/laws.shtml>

73) *See* Pointer and Schroeder, *supra* note 67, at 21.

74) *Id.*

3) restrict insider trading; and 4) disclose tender offer solicitations.⁷⁵⁾

The SEC is subcomposed of many divisions to regulate and enforce the 1933 and 1934 provisions. The SEC's Division of Enforcement plays the most prominent role within securities enforcement regulation. The Division of Enforcement is responsible for the review and direction of all enforcement activities of the regional offices, supervision of investigations conducted pursuant to federal securities laws, and the pursuit of injunctive actions.⁷⁶⁾ Specifically, the SEC's Division of Enforcement seems most concerned with four areas of financial fraud: 1) failure to disclose liquidity problems; 2) lack of adequate discussions regarding adverse operating results; 3) insufficient provisions for uncollectible and nonperforming loans; and 4) the use of deceptive and fraudulent accounting practices.⁷⁷⁾ The division also reviews cases sent to the Department of Justice for criminal prosecution and determines whether available evidence supports complaint allegations.⁷⁸⁾

B. The Korean SEC - Judicial Capacity for Enforcement

The Korean SEC and the SSB were created in February 1977⁷⁹⁾ pursuant to a 1977 amendment to the Securities and Exchange Act.⁸⁰⁾ The KSEC represented an independent administrative commission, with the primary mission to review and resolve matters related to issuance and transactions of securities.⁸¹⁾ Further, the KSEC conducted its investigations under the auspices of the SSB's multiple

75) *Id.*

76) *Id.* at 17.

77) *Id.*

78) *Id.*

79) The Ministry of Finance and Economy (MOFE), Korea Investment Corporation (KIC) and the Korea Stock exchange (KSE) were three major institutions regulating the securities market before the Korea Securities and Exchange Commission (KSEC) and the Securities Supervisory Board (SSB) were established as major regulators. The Financial Supervisory Commission (FSC) formed in 1998 later consolidated the separate securities, banking and insurance regulators as the chief supervisor for the financial sector. *See* Chapter 2 Development of the Korean Securities Market 14,16 available at http://www.ksda.or.kr/UPLoADFILES/ch2_Development_of_the_Korean_Securities_Market.pdf

80) *Securities Market System in Korea*, Securities Supervisory Board 17 (Seoul, 1996).

81) *Id.*

divisions and respective responsibilities.⁸²⁾ Other agencies, like the KSE, were also delegated certain regulatory powers to assist the KSEC and SSB in securities enforcement.⁸³⁾

Specifically, regarding securities companies, the KSEC was responsible for the limitation on excessive positions on securities, prohibition on owning real estate unrelated to business purposes, review of financial statements, and the submission of business reports, or prospectuses to the KSEC.⁸⁴⁾ Regarding enforcement procedures, the KSEC was responsible for the investigation, enforcement, and alternative dispute resolution proposals for securities violations.⁸⁵⁾

The KSEC's legislative authority was mostly derived from the Securities and Exchange Act (SEA) of 1977^{86),87)} Within Article 1 of the SEA, however, had been an inherent legislative conflict that stymied the KSEC's mandate and independence from its inception. Specifically, Article 1 states that the SEA's purpose was to assist in the "development of the national economy." Therefore by virtue of the KSEC's legislative authority being derived from articles such as Article 1 of the SEA, the KSEC's regulatory scope was constrained in that it could regulate the securities markets only to the extent that it fostered (not hindered) economic growth, irrespective of whether such actions constituted sound regulatory actions or not. Had the term "development" within SEA Article 1's language simply been replaced by alternative legislative language (albeit in the SEA's original 1977 version or vis-a-

82) The External Audit Review Board (EARB) was established and placed within the SSB in order to provide the KSEC with special and technical advice on auditing operations.

83) The KSE reserves the right to inquire directly into listed companies about rumors in the market when necessary. The KSE may also suspend the share transaction of a listed company in case the company does not implement its disclosure obligations within the time limits in the KSE's regulation.

84) *See Securities Market System in Korea*, *supra* note 80, at 23.

85) *Id.*

86) Article 1 of the SEA explains the Act's purpose. That is, "to contribute to the development of the national economy by attaining wide and orderly circulation of securities, and by protecting investors through the fair issuance, purchase, sale or other transaction of securities."

87) The Securities and Exchange Act was wholly amended by Law No. 2920, Dec. 22, 1976. Four subsequent amendments ensued:

- 1) Law No. 3541, Mar. 29, 1981;
- 2) Law No. 3945, Nov. 28, 1987;
- 3) Law No. 4469, Dec. 31, 1991;
- 4) Law No. 4701, Jan. 5, 1994

vis a later legislative amendment), the KSEC's independence, scope, and authority could have been notably improved.

Table 3 Audit Reviews and Detected Violations in 1996

(Unit: Cases)

	CLASSIFICATION	AUDIT REVIEWS	VIOLATIONS
On-Audit Reports	General	43	7
	Occasional	92	14
	Ad-hoc	2	2
	Others	11	18
	SUB-TOTAL	148	41

Source: Korea Securities and Exchange Commission, *Annual Report* (1996).

Moreover, several other specific SEA⁸⁸⁾ articles existed pertaining to the Commission's investigatory breadth. Article 128,⁸⁹⁾ for example, authorized the KSEC to investigate any persons responsible for violations of the Act for "the public interest or for the protection of investors".⁹⁰⁾ Article 129 authorized the Commission to request any administrative agency or like institution to "render such cooperation

88) The Korean Securities and Exchange Act (SEA) is the main legislative act of the Korean securities market. It also covers all securities related institutions. Its main purpose is to ensure fair trading, to protect investors and to assist the development of Korea's economy. The SEA underwent revisions in the 1970s during the rapid growth of Korea's security market, in the 1990s after MOFE revealed its plans to liberalize the securities market and after the financial crisis the revisions focused on market liberalization and the acceleration of financial and corporate sector restructuring. See Securities and Exchange Act available at <http://www.ksda.or.kr/english/invest/laws.cfm>

89) Specifically, Article 128 of the SEA may compel a person to perform the following:

- 1) To submit a written statement on the facts and circumstances with respect to matters being investigated;
- 2) To be present at the Commission for witness; and
- 3) To submit such accounting books, records and other materials as may be deemed necessary.

90) *Securities and Exchange Act*, Chapter VII, Securities and Exchange Commission, Section 1, Establishment and Organization (in Securities Market Regulation in Korea (Seoul, 1996).

as deemed necessary" in the course of its duties.⁹¹⁾ Further, under Article 129, the KSEC could request any financial institution to restrict financial support to a corporation under investigation.⁹²⁾ Also, Article 188 detailed the Commission's authority to compel disgorgement of insider short-swing profits.⁹³⁾ Article 188-2 restricted insider trading, while Article 188-3 set forth liability for insider trading damages.⁹⁴⁾

Once the KSEC or SSB detected any sign of securities law violation, the agency conducted, after securing the Governor's approval, an informal investigation⁹⁵⁾ in which it gathered information on suspected accounts and transactions.⁹⁶⁾ Under a formal investigation, the Korean SEC could compel the appearance of suspects or witnesses, and the production of books and records under the authority of the previously mentioned SEA provisions.⁹⁷⁾ At the conclusion of an examination or investigation, the Division of Examination and Enforcement (which represented the KSEC's main investigatory and enforcement agencies) was required to submit a complete report on their findings to a Commission meeting.⁹⁸⁾

If a securities law violation existed, the KSEC could, in theory, report it to the Public Prosecutor's Office for criminal action or impose "administrative

91) *Id.*

92) *Id.*

93) Pursuant to Law No. 3541, Mar. 29, 1982, a related lawsuit initiated by the Commission or a stockholder in accordance with Paragraphs (2) and (3) of Article 188, may claim the legal costs and other expenses actually incurred against the corporation concerned.

94) Paragraph (1) of Article 188-2 states that a person violating this provision shall be liable for "damages which a person who has made a purchase or transaction or securities" suffers. However, one's claim for damages shall be extinguished by prescription if the claimant fails to exercise it for one year after that person is informed of the fact that an act contrary to the provisions of Article 188-2 was committed, or for two years after the offense took place. (Article Newly Inserted by Law No. 4469, Dec. 31, 1991).

95) The US Securities and Exchange Commission took enforcement action against PNC Financial Services Group, Inc. in July 2002 due to PNC's Improper Accounting and Disclosures concerning the transfer of \$762 million of loans and other assets to special purpose entities. The Commission Ordered PNC to Cease and Desist From Violating Antifraud, Reporting and Record-Keeping Provisions of Federal Securities Laws. See US Securities and Exchange Commission available at <http://www.sec.gov/news/press/2002-109.htm>

96) *Work of the SEC and SSB*, Securities and Exchange Commission, Securities Supervisory Board 15 (Seoul, Oct. 27, 1997).

97) *Id.*

98) *Id.*

sanctions".⁹⁹⁾ However, such actions were extremely rare, and were not explicitly authorized by SEA provisions. Administrative sanctions, besides those previously mentioned, had also included suspension of business,¹⁰⁰⁾ and monetary compensation for false statements.¹⁰¹⁾ The Sanction Committee, composed of Division of Examination directors, the Division of Examination Planning director, and three assistant governors and deputy governor of the SSB, issued sanctions on behalf of the authorized body.¹⁰²⁾

Table 4 KSEC's Enforcement on Unfair Trading in 1994

(Unit: persons)

ACCUSATION	DISGORGEMENT OF SHORT-SWING PROFIT	WARNINGS	REQUEST FOR CARE	OTHERS
21	6	25	23	52

Source: Korea Securities and Exchange Commission, *Annual Report* (1996).

The Korean Securities and Exchange Commission and the Securities Supervisory Board acted jointly in securities regulatory duties, though the KSEC ultimately fell

99) *Id.*

100) Specifically, SEA Article 57 states that "the Commission may order to suspend the business in whole, or in part..." by showing sufficient cause (Amended by Law No. 3541, Mar. 29, 1982; Law No. 4469, Dec. 31, 1991; Law No. 4701, Jan. 5, 1994).

101) Article 14 of the 1977 Securities and Exchange Act details liabilities for compensation due to false statements. Specifically, if any purchaser incurs a loss because of a false or misleading statement within a registration statement or prospectus, the alleged wrongdoer shall be liable to compensate for that loss (Amended by Law No. 4469, Dec. 31, 1991). Further, Article 15 stipulates that the amount to be compensated for loss under Article 14 shall be the difference between the amount actually paid by the claimant for the acquisition of the securities and either of the following:

- 1) The market value of the securities as of the time of the closing of oral proceedings, if a lawsuit is entered against the securities concerned (in case no market values are available, an estimated value at the time the securities would be disposed); and
- 2) The value at which the securities were disposed of, in case such disposition of the securities has been made prior to the time of the closing of oral proceedings referred to in Paragraph (1) of this Article (15).

102) Annual Report 1996, Korea Securities and Exchange Commission, Securities Supervisory Board, 45 (Seoul, 1996).

under the greater authority of the SSB.¹⁰³⁾ In particular, the relevant investigatory duties were delegated to several subdivisions, each with specific responsibilities, somewhat patterned after the American model. For example, the SSB's Division of Examination Planning located evidence and offered opinions about regulations violations by institutions and individuals.¹⁰⁴⁾ Second, The Division of Examination was divided into three subcomponents. Divisions of Examination I and II conducted scheduled examinations of securities companies.¹⁰⁵⁾ Division of Examination III made regular visits to securities-related institutions, such as the Korean Securities Dealers Association (KSDA), and the domestic branches of foreign securities companies.¹⁰⁶⁾ This division also examined investment trust companies and investment advisory companies. The Division of Enforcement Planning constructed agendas for SEC meetings based on investigators' findings.¹⁰⁷⁾ Also, the Divisions of Enforcement (I and II) were responsible for the investigation of fraudulent activities, such as insider trading and market manipulation in the marketplace based on their own findings and referrals from the KSE, which operated automated market surveillance programs.¹⁰⁸⁾

Interestingly, a Division's of Disputes Mediation-not found in the U.S. SEC-existed.¹⁰⁹⁾ This division oversaw disputes between a securities company and aggrieved clients. The division's staff investigated disputes, which later went on to the Securities Dispute Mediation Committee.¹¹⁰⁾ If both parties accepted the Committee's mediation proposal, the decision had the same effect as a judicial accord.¹¹¹⁾

103) The Financial Supervisory Commission has finished the necessary work to improve the soundness of financial institutions and financial supervisory levels. Four existing supervisory agencies (Banking Supervisory Authority, Securities Supervisory Board, Insurance Supervisory Board, and Non-banking Supervisory Authority) have been fully consolidated into the Financial Supervisory Service (FSS) in January 1999. FSC/FSS will continue to focus on strengthening financial supervision by making the most of the technical assistance loans from the IBRD in process and by acquiring advanced supervision and examination techniques and skills developed in foreign supervisory organizations.

104) *See supra* note 102.

105) *Id.*

106) *Id.*

107) *Id. at* 69.

108) *Id.*

109) *See Securities Market System in Korea, supra* note 80 at 21.

110) *Id.*

111) *Id.*

C. The United States SEC - History and Provisions

The United States Securities and Exchange Commission (SEC) is an independent institution with quasi-legislative and judicial power.¹¹²⁾ The SEC also possesses the authority to undertake administrative regulation.¹¹³⁾ In contrast, the Korean SEC (KSEC)¹¹⁴⁾ was only entitled to review and decide matters authorized by the MOFE.¹¹⁵⁾ On paper, the KSEC represented the “supreme organization for securities policy execution”¹¹⁶⁾ though in practice, such may not have been the case because the KSEC was not a fully autonomous agency.

Although basically similar to the United States Securities and Exchange Commission, the Korean SEC regulated margin trading.¹¹⁷⁾ However, in the U.S., this duty is regulated by the U.S. Federal Reserve Board. Moreover, enforcement functions are performed by the SSB in Korea, whereas this task is performed by the U.S. SEC under its “quasi-judicial” powers.

The KSEC could impose penalties through civil or, in rare cases, criminal liability. An individual may have been subjected to criminal liability, for instance, for not fully satisfying disclosure requirements when making a public offering, and by publishing misleading statements or improper registration statements or

112) THEODORE A. LEVINE AND GARY G. LYNCH, BANKS, THE SEC, AND REGULATORY AGENCIES: ENFORCEMENT AND CIVIL LITIGATION DEVELOPMENTS 13 (Corporate Law and Practice, Course Handbook Series, Number 476, 1985).

113) *Id.*

114) The original objective of the Ministry of Finance and Economy (MOFE) was to integrate public finance sector operations, including the budget, national treasury and taxation, to improve policy consistency and effectiveness. However, over-concentration of policy decision-making had negative effects on the checks and balances required for effective government. To avoid over-concentration and improve government sector competitiveness and productivity, budgetary authority was transferred to the Ministry of Planning and Budget. Financial supervision became the responsibility of the Financial Supervisory Commission. The monetary and credit policy decisions assigned to MOFE were also transferred to the Bank of Korea in 1998. *See Purpose available at <http://english.mofe.go.kr/about/dpm.html>*

115) Additionally, the KSEC is responsible for the cooperation and coordination of information-sharing with foreign regulatory authorities. The SEC/SSB became a member of the International Organization of Securities Commissions (IOSCO) in 1984, and signed the Resolution on Mutual Assistance in 1986.

116) *See supra* note 103.

117) SEA Art. 9, authorizing the price ceilings, collateral ratio application to margin trading, and collection methodology.

prospectuses.¹¹⁸⁾ For example, an issuer or underwriter who failed to make a proper offer in the pre-filing period to a potential investor could have been subject to a criminal sanction of up to two years imprisonment, and a ten million Korean won¹¹⁹⁾ fine.¹²⁰⁾ Further, the penalty for misleading or improper registration statements or prospectuses could result in sanctions of up to one year imprisonment and a five million won fine.¹²¹⁾

Articles 14 and 197 of the SEA were the only two provisions that created civil liability related to securities distribution.¹²²⁾ Article 14 imposed civil liability for untrue statements or omissions of material facts, and false or misleading statements within auditing statements in registration statements or prospectuses.¹²³⁾ Article 197 imposed civil liability upon an auditor due to an omission of material fact or misleading statements¹²⁴⁾ in auditing statements within a registration statement or a prospectus.¹²⁵⁾ The SEA¹²⁶⁾ did not impose civil liability upon persons making a secondary distribution of securities, persons controlling the issuer, and aiders and abettors.¹²⁷⁾

118) *See Song, supra* note 45, at 9.

119) “Won” denotes Korean currency. For matters of convenience, and easy conversion, 1000 Korean won equals approximately 1 U.S. dollar.

120) *See Song, supra* note 45, at 9.

121) *See SEA* at arts. 13, 210.

122) *See id.* at arts. 14, 197.

123) *See id.* at art. 14.

124) This is against the main objective of the Korean Securities Exchange Act. Specifically, the SEA focuses on ensuring fairness of transactions in both the issuing and trading of securities and in protecting investors. The SEA is dedicated to matters like investor protection, timely disclosure, issuer registration, public offering, secondary market distributions, tender offers, insider trading and the regulation of securities businesses and investment advisors to realize these objectives. *See Securities and Exchange Act available at <http://www.ksda.or.kr/english/dataroom/law.cfm>*

125) *See SEA* at art. 197.

126) The SEA subjects the following persons to civil liability:

- 1) registrants of the registration statement, or any person who has prepared or delivered the prospectus;
- 2) directors of the issuer at the time of filing of the registration statement was filed prior to the incorporation of the issuer;
- 3) certified public accountants or appraisers who has prepared the audit report included in the registration statement;
- 4) underwriters or dealers who has entered into an underwriting agreement with the issuer.

127) *See Song, supra* note 45, at 771.

A person subject to such civil liability has two defenses.¹²⁸⁾ The first legal defense arises when evidence demonstrates that the defendant had no knowledge of untrue statements or omission of material facts upon exercise of due diligence, and therefore, no liability will be imposed.¹²⁹⁾ Second, a defense arises when such persons can demonstrate that the purchaser of the related securities knew of the untrue statement or omission at the time of the offer to purchase the securities.¹³⁰⁾

Under SEA Articles 14, 15, and 197, securities purchasers could recover damages incurred from untrue statements or omissions of material fact in a registration statement¹³¹⁾ or prospectus.¹³²⁾ Damages were calculated by the difference between the securities price that the purchaser paid and the market price of the securities.¹³³⁾ Moreover, the purchaser had one year from the discovery of the Article 14, 15 or 197 violation, or three years from the effective date of the registration statement, whichever comes earlier, to file a claim under these SEA provisions.¹³⁴⁾

The U.S. Securities and Exchange Commission (SEC) contains similar provisions concerning liability. Section 12 of the Securities Act of 1933 stipulates civil liabilities arising in connection with a prospectus and/or certain communications.¹³⁵⁾ Specifically, any person offering or selling securities, which includes untrue statements or omission of material facts, under reasonable care, shall be liable to the person purchasing such security.¹³⁶⁾ The aggrieved party may then “sue either at law or in equity in any court of competent jurisdiction to recover the consideration paid for such security with interest...less the amount of any income received”.¹³⁷⁾

128) See SEA at art. 14.

129) *Id.*

130) *Id.*

131) US Securities Act (Act) of 1933 Section 11 regulates Civil Liabilities on Account of False Registration Statements. Section 11 of the Act gives those disadvantaged by misleading or omitted information in a registration statement the right to sue. See Securities Act of 1933 Section 11-Civil Liabilities on Account of False Registration Statement available at <http://www.law.uc.edu/CCL/33Act/sec11.html>

132) See Song, *supra* note 45, at 771.

133) See SEA at art. 15.

134) See SEA at art. 16.

135) See Securities Act of 1933, § 12.

136) *Id.*

137) *Id.*

Section 11 of the Securities Act provides for civil liability on account of false registration statements.¹³⁸⁾ Damages are authorized under Section 11(a), and are derived by the difference between the amount paid of the securities and the value at the time of such suit, the market price of the security prior to the suit, or other stipulated securities values.¹³⁹⁾

The Securities Exchange Act of 1934¹⁴⁰⁾ granted added regulatory authority to the SEC. Section 10 details provisions regarding the use of manipulative and deceptive devices, with the purchase or sale of any security.¹⁴¹⁾ Section 12 stipulates registration requirements for securities, while Section 13¹⁴²⁾ relates to periodical and other reports.¹⁴³⁾ Under the 1934 Act, any individual who is even placed in a controlling position over a person liable under any provision of this title shall be liable “jointly and severally”.¹⁴⁴⁾

Section 21, related to investigations, injunctions and prosecutions of offenses, represents perhaps the most prominent provision granting the SEC quasi-judicial powers. Under this provision, the Commission may “in its discretion bring an action in the proper district court...to enjoin such acts or practices”.¹⁴⁵⁾ Further, the Commission may transmit evidence of possible infractions to the Attorney General’s Office who, under its discretion, may invoke criminal proceedings against an alleged party.¹⁴⁶⁾ An action brought by the SEC in a United States district court may impose a civil penalty¹⁴⁷⁾ upon a person; the amount not to exceed three times the profit gained or loss avoided as a result of such unlawful purchase or sale, payable to the United

138) See Securities Act of 1933 at § 11.

139) See *id.* at § 11(e).

140) Securities Exchange Act of 1934, *supra* note 72.

141) See Securities Exchange Act of 1934, § 10.

142) Section 12 of the Securities Exchange Act states that the Commission shall require “to keep reasonably current the information and documents required to be included in or filed with an application or registration statement filed pursuant to section 12.”

143) See *id.* at § 12, 13.

144) See *id.* at § 20.

145) See *id.* at § 21.

146) *Id.*

147) Section 21(B) states that “No person shall be subject to a sanction...solely because that person aided and abetted a transaction”, and further, “No person shall be liable...solely by reason of employing another person who is liable under this paragraph.”

States Treasury.¹⁴⁸⁾¹⁴⁹⁾ Section 25 also provides that an aggrieved party can obtain a review of an order in the United States Court of Appeals for the circuit in which the party resides, or has a principal place of business.¹⁵⁰⁾

Table 5 Topics Discussed at KSEC Meetings in 1996

ITEM	CONTENT	CASES
Bills	1. Enactment of and amendment to the rules of the KSEC and SSB.	84
	2. Consideration and admission to the enactment or amendment to the rules of securities-related institutions.	34
	3. Licensing and admission of securities companies.	24
	4. Reviews on underwriting of publicly-offered shares.	46
	5. Enforcement action against the results of inspection.	4
	6. Others	17
SUB-TOTAL		209
Reports	1. Monthly report of proceeds from corporate securities offerings	51
	TOTAL	

Source: Korea Securities and Exchange Commission, *Annual Report* (1996).

D. Comparative Constitutional Considerations

To better understand the legal parameters of the Korean SEC, the Korean legal system should be considered.¹⁵¹⁾ Further, the primary purpose of this section is not to state that one municipal legal system is better or worse than the other, but rather to

148) Similarly, any disgorged ill-gotten gains from convicted wrongdoers are directed towards the United States Treasury. Because of the concern of the Commission's independence, and concerns of self-checking mechanisms, Congress chose not to redirect such funds to the SEC, that it could lead too easily towards corruption and over-aggressive policing activities.

149) *Id.*

150) *Id.* at § 25(a)(1).

151) The Korean legal system is a continental law system, and the modern Korean legal system originally followed the European civil law system as transferred in part from the Japanese legal system. US law also influenced Korean law following World War II and the Korean War (1950-53). In the late 1980s and 1990s there

note that such differences exist given the comparative nature of this article, especially as it relates to Korea's historical tendency of a strong executive branch.

Overall, Korea and the United States exist under two different legal systems, with several notable distinctions. First, codes and statutes represent the primary sources of law which bind Korean courts.¹⁵²⁾ Because the Korean legal system is based on the continental system, Korean case law does not carry the same judicial weight as in the U.S. legal system. In such a structure, the executive branch's presence relating to securities regulation was relatively less subtle in the Korean system than the U.S. system, which may have represented one of many factors that stymied the KSEC's independence.

Korean case law, however, typically becomes important when a lack of statutory authority, or perhaps foreign case law¹⁵³⁾ exists.¹⁵⁴⁾ Much like common law countries, higher courts in Korea can override lower court decisions.¹⁵⁵⁾ Despite this judicial hierarchy, and because of codification interpretation¹⁵⁶⁾ by Korean courts, little room remains for *stare decisis*¹⁵⁷⁾ deference.¹⁵⁸⁾ However, courts can appeal to law professors and academic opinions in code and statute interpretation.¹⁵⁹⁾ Moreover, under civil law, the courts lack enforcement authority to enjoin administrative

was much democratic reform in the law working towards improving the Korean legal system. The 1997 financial crisis also had a massive effect on Korean law resulting in systematic deregulation and proliferation of new laws and regulations. See Korean Legal System available at <http://www.law.siu.edu/lawlib/koreanlaw/#koreanlegal>

152) Jae Yeol Kwon, *An Isolation in Systems of Law: Differences Between the Commercial Codes of the United States and Korea*, 29 LOY. L.A. L. REV. 1095, 1099 (1996).

153) As mentioned in the previous section, the Korean Constitution derives many of its components from U.S., German, and Japanese legal theories. In particular, Japanese case law plays an integral party in relation to the interpretation of the Korean Commercial Code (KCC).

154) See Kwon, *supra* note 152, at 1099.

155) *Id.*

156) The courts' interpretation of the Korean Commercial Code—equivalent to the U.S. Uniform Commercial Code (UCC)—is a prime example of the rigid and strict interpretation Korean courts apply to codified statutes. In fact, evidence suggests that Korean courts are committed to a "straightforward literal" analysis.

157) The doctrine of *stare decisis* gives a binding effect to precedents in common law, such as in the US and England. In contrast, South Korea is a civil law jurisdiction in which courts refer to codified statutes. Precedents of Korean courts lack the binding effect they have in countries with the common law system. See COOK, CREYKE, *Geddes, Holloway, Laying Down The Law* (5th ed) 435 (Butterworths, 2001)

158) See Kwon, *supra* note 152, at 1099.

159) *Id.*

dispositions deemed unlawful.¹⁶⁰ In fact, no provisions explicitly exist granting courts the power to enforce their decisions or to enjoin administrative dispositions.¹⁶¹

The second major distinction between the Korean and American judicial models relates to the notion of federalism. Korea is not a federalist country. Therefore, codified legislation like the Korean Securities and Exchange Act constitutes an integral part of a national legal system. Consequently, when rendering decisions, Korean courts are not faced with issues of *stare decisis*, uniformity, and legal precedence like in other jurisdictions.

In many ways, the composition of the U.S. Securities and Exchange Commission reflects the American federalist structure. For example, the main SEC headquarters are in Washington, D.C. In addition to the SEC's main D.C. Headquarters, SEC regional offices exist to handle cases in their assigned jurisdictions.¹⁶² Specifically, the SEC is organized into eight regional areas, each with a regional office.¹⁶³ Also, seven branch offices exist to assist the regional offices.¹⁶⁴ A major part of the investigation activities conducted by the regional offices concerns brokers and dealers.¹⁶⁵¹⁶⁶ All SEC regional offices must write an official memorandum for D.C. Headquarter approval, including the initial SEC Formal Order of Investigation (FOI), which allows staff attorneys to subpoena documents and persons to SEC offices.¹⁶⁷

160) Dae-Kyu Yoon, *New Developments in Korean Constitutionalism: Changes and Prospects*, 4 PAC. RIM L. & POL'Y J. 395, 412 (1995).

161) *Id.*

162) Some of the more prominent regional offices, in terms of number of cases investigated, include New York City, Chicago, Los Angeles, San Francisco, and Atlanta. The California offices encompass a vast geographic region, including the states of Alaska and Hawaii. A Washington regional office also exists. However, the office has received little recognition or notoriety because major cases are inevitably transferred to D.C. headquarters.

163) See LARRY GENE POINTER AND RICHARD G. SCHROEDER, AN INTRODUCTION TO THE SECURITIES AND EXCHANGE COMMISSION 17 (1996).

164) *Id.*

165) All registered dealers are subject to surprise inspections to ensure compliance with statutory provisions, especially regarding accounting procedures.

166) See POINTER AND SCHROEDER, *supra* note 163, at 17.

167) The SEC is a government agency founded in 1934 to administer and enforce the Federal securities laws. The objective of the SEC is assisting investors by providing reliable information to them. The SEC requires full and equitable disclosure of information during the offer and sale of securities. See The Securities and Exchange Commission, available at <http://www.uwm.edu/~ceil/doc/audnotes/sec.doc>

The U.S. SEC main headquarters is also the location where SEC Commissioners hold closed-door sessions to discuss and vote upon SEC policies. Moreover, much like the Korean SEC, the D.C. office is divided into five divisions, some of which have overlapping authority, each focused on specific matters of securities regulation.¹⁶⁸ These five divisions include the following: market regulation, corporate regulation, investment management, corporation finance, and enforcement.¹⁶⁹ The D.C. Office also includes a Division of International Affairs, similar to that found in the Korean SEC, which handles transactions, such as serving process and subpoenas across U.S. borders.¹⁷⁰

The third distinction between the two legal systems lies in the differing constitutional application of the separation of powers. Since the formation of Korea's republican government, the relationship between the legislative and executive branches has been characterized by a weak legislature and strong executive branch.¹⁷¹ The governing party has historically controlled Korea's National Assembly to the point where the legislature was a subordinate agent of the executive branch.¹⁷² Most Assembly members of the ruling party were "fully" under the control of the President, who has also been head of the party.¹⁷³

Essentially, the executive branch's historically overpowering authority¹⁷⁴, and lack of separation of powers presented a problem for the KSEC in maintaining its autonomy. In contrast, the U.S. SEC has maintained its reputation for political independence, despite the presidentially-appointed nature of the Chairman's position. In 1981, for example, President Reagan appointed Jack Shad as SEC

168) See POINTER AND SCHROEDER, *supra* note 67, at 17.

169) *Id.*

170) For a general discussion of a case which may involve the SEC's Office of International Affairs, see generally, Darrell Hall, *No Way Out: An Argument Against Permitting Parties to Opt Out of U.S. Securities Laws in International Transactions*, 97 COLUM. L. REV. 57 (1997).

171) See Yoon, *supra* note 160, at 403.

172) *Id.*

173) *Id.*

174) The Korean executive branch has been historically powerful relative to the legislative and judicial branches since 1945. This was based on the national security law emphasizing national security against the threat of the communist regime in North Korea. This resulted in the creation of a security infrastructure of expansive scope and power centered around a strong executive. See Dr. Jon Moran, *Making Intelligence Accountable: Legislative and Executive Oversight In Old and New Democracies South Korea's National Intelligence Service* 6 available at http://www.dcaf.ch/legal_wg/ev_oslo_030919_moran.pdf

Chairman, who dictated certain SEC policies not fully congruent with the White House agenda.¹⁷⁵⁾ At the same time, minimal communication existed between the White House and the SEC Chairman.¹⁷⁶⁾

The notion of the KSEC's political independence was constrained for several other reasons. First, Korea's history of heavy state intervention¹⁷⁷⁾ invited political tampering with economic affairs. The state justifies its political tampering by arguing that many KSE listed companies are vital to the Korean economy. Second, because the Korean president could select several commission members, the state maintained a direct presence in KSEC affairs, such as public and economic policy. In the U.S., such decisions are made in sessions behind closed-doors. Third, the KSEC was a subdivision of the Securities Supervisory Board (SSB), which in turn, ultimately reported to the Ministry of Finance and Economy (MOFE). This hierarchy of authority stymied and distracted the Korean SEC's mission of effective securities regulation and enforcement.¹⁷⁸⁾ At the very least, this administrative hierarchy, existing prior to 1997, implied that securities enforcement was inextricably linked with economic growth. In contrast, the United States SEC is a relatively true "independent" government agency, with the sole purpose of protecting investors against fraudulent securities transactions.

175) DAVID A. VISE AND STEVE COLL, *EAGLE ON THE STREET* 1-3 (1991).

176) *Id.* at 143. Communication between the White House and the SEC Chairman was so minimal that the Chairman once noted calling directory assistance to obtain the White House's general phone number. Even when connected inside, Shad still faced difficulty gaining clearance from staff members to speak to then Vice-President George Bush. *Id.*

177) For a broad overview and history of the heavy state role in Korea's post-War period, see generally, LEROY P. JONES AND IL SAKONG, *GOVERNMENT, BUSINESS, AND ENTREPRENEURSHIP IN ECONOMIC DEVELOPMENT: THE KOREAN CASE; STUDIES IN THE MODERNIZATION OF KOREA* (1980); ALICE AMSDEN, *ASIA'S NEXT GIANT: SOUTH KOREA AND LATE INDUSTRIALIZATION* (1989).

178) The Ministry of Finance and Economy (MOFE), which underwent major changes and lost some supervisory powers during the financial restructuring process was often criticized for bureaucratic supervision and bureaucratic finance. The new financial system established after the Asian financial crisis is defined by a division of powers and functions between public agencies like MOFE, Financial Supervisory Commission (FSC) and the Korean Deposit Insurance Corporation (KDIC) that are responsible for the financial system. See Hong-Bum Kim *Financial Stability and the Public Agencies Concerned: The Case for Supervisory Cooperation and Checks and Balances* 21-22 available at http://www.bok.or.kr/contents_admin/info_admin/eng/home/public/public03/info/021.pdf

IV. Concluding Remarks

A. Reasons for the KSEC's Ineffectiveness

The KSEC was, in many ways, constrained in its ability to enforce the duties conferred on it by the Korean Securities and Exchange Act (SEA). Most notably, the Korean SEC did not possess the explicit judicial authority to enjoin parties from fraudulent or other illegal acts. Though the KSEC could issue fines, and offer stern recommendations condemning behavior, the inability of the KSEC, and even Korean courts, to offer injunctive relief or impose criminal liability represented a severe hindrance to securities enforcement before 1997. That is, along with inherent difficulties to compel persons to testify, and comply with its investigations, the KSEC did not possess the explicit authority to invoke court assistance for injunctive requests.¹⁷⁹⁾

Moreover, the KSEC needed fundamental reorganization to improve its efficacy in regulating transactions within the KSE.¹⁸⁰⁾ Specifically, the Korean SEC should have been created as a fully autonomous organization, detached from both SSB and MOFE authority. By doing this, the KSEC would have been fully committed to enforcing the policies, both regulatory and in enforcement, necessary to protect investors from fraudulent securities transactions, without undue state and political influence.¹⁸¹⁾

On a broader scale, the Korean government did not take the necessary action to improve the general efficiency of the Korean securities market prior to the 1997 Asian financial crisis. For instance, the state failed to take concrete and determined steps towards the liberalization and globalization of the KSE. At the same time, the

179) See Song, *supra* note 45, at 771.

180) When the many aspects affecting financial stability are interrelated this indicates the extent of complementarity between public agencies in information, powers and expertise. Complementarity depends on how institutional division of powers and mandates is defined and how activities of public agencies are coordinated. The multifaceted aspect of financial stability requires supervisory cooperation, checks and balances between public agencies. See Hong-Bum Kim, *supra* note 178.

181) Professor Mark J. Roe of Columbia Law School notes the pervasive impact political influences, like interest groups, can have on corporate finance, "egalitarian" democracy, and public corporations. See Mark J. Roe, *A Political Theory of American Corporate Finance*, 91 COLUM. L. REV. 10, 66 (1991). Roe even goes so far as to declare that "Politics molded the modern corporation". *Id.*

state did not bring its domestic practices in line with international standards¹⁸²⁾. For example, an international standard of prospectus production guidelines, and issuances and sales procedures was never fully instituted.

Conforming the KSEC, along with the KSE, to international standards would have fulfilled two purposes. First, it would have increased the transparency of the Korean securities marketplace, thereby deterring opportunities for fraudulent and corrupt practices. Second, international standards within the Korean marketplace at this time would have enabled increased international securities enforcement between the U.S. and Korea, which would have thus broadened the KSEC's ability to investigate and prosecute securities violations.¹⁸³⁾

The Korean Securities and Exchange Act (SEA)¹⁸⁴⁾ should also have been amended to better assist the KSEC's enforcement endeavors. First, the SEA should have contained explicit provisions, giving the KSEC authority to compel persons to testify, under oath, within a formal investigation or judicial proceedings. Second, SEA provisions should have also included the explicit authority to invoke injunctive relief when deemed necessary. Third, the SEA should have also better addressed the following issues: fine-tuning accounting standards for more effective auditing, additional regulations focused on mergers and acquisitions, and greater court

182) On October 11, 1996, the Republic of Korea (ROK) was admitted as the OECD's 29th member country. As part of its membership agreement, the Korean securities market has increasingly lowered its barriers to foreign investment and investors. For example, it is expected that the current 12% aggregate limitation for foreigners will eventually be curtailed to a nominal level in the next decade. See Song, *supra* note 45, at 778.

183) The Hague Convention on the Taking of Evidence Abroad in Civil or Commercial Matters represents the first concrete agreement through which member states could request assistance from each other to obtain evidence "for use in judicial proceedings, commenced or contemplated." See Elliott M. Beard, *A Critical Analysis of the Effects of Colello v. Secon International; Securities Law Enforcement Agreements*, 7 DUKE J. COMP. & INT'L L. 271, 271-272 (1996). However, the Hague Agreement applies only to civil judicial proceedings, and is thus inapplicable to the U.S. SEC's administrative actions and requests. *Id.* Second, Mutual Legal Assistant Treaties (MLATs) can be used, which are bilateral treaties to assist in the cross-border investigation and prosecution of criminal violations. *Id.* at 272. Third, there exists the Memorandum of Understanding (MOU); non-binding statements between countries to facilitate the exchange of information and mutual cooperation in securities violation investigations. *Id.*

184) The Korean securities market is principally regulated by the SEA, including the supervision of securities-related institutions. The SEA's main purpose is to ensure fairness of transactions in both the issuing and trading of securities, to facilitate the trading of securities, to protect investors, and to promote development in the nation's economy. See Securities and Exchange Act available at <http://www.ksda.or.kr/english/dataroom/law.cfm>

discretion in rendering harsher punishments, both monetary and injunctive.¹⁸⁵⁾ Following the 1997 financial crisis, the Korean legislature took several broad stroke measures in this direction, but more aggressive legislation is still required to improve Korea's financial infrastructure and to bolster global investor confidence.

B. Prospects for the Future

In a global market, rational investors will engage in transnational financial arbitrage, seeking those stock exchanges with relatively sound and transparent regulation. Therefore, all market regulators in Korea must make determined efforts to maintain and also expand support for securities regulatory bodies that support such principles. The KSE already has experienced increased securities volume trading, from domestic and foreign investors, which is bound to increase in the foreseeable future.¹⁸⁶⁾

In the meanwhile, the Korean financial system in the post-1997 period, with its comprehensive liberalization policies and opening of its market, will increasingly integrate into international capital markets and the global economy.¹⁸⁷⁾ Thus far, Korea's current financial transformation has been relatively successful in terms of attracting global investor's attention. Therefore, the ever-changing and increasing use of the Korean securities market by both domestic and foreign investors will consequently demand that changes, like those recommended in this paper, be seriously considered relating to securities regulation now and in the near future.

185) See generally, Hong, *supra* note 25, at 1, 3.

186) Even assuming the same percentage of securities violations, the sheer volume increase in securities transactions will inevitably equate to increased regulatory investigations by the KSEC.

187) Financial liberalization is likely to result in an inflow of foreign capital. This is due to expectations of high returns and an assumption that either the government or international agencies will protect investments by a government safety net or other methods. However, uncertainties and market decline are likely to result in moral hazards and financial crisis. J. H. Hahm and F. S. Mishkin, *The Korean financial crisis: an asymmetric information perspective* 26 *Emerging Markets Review* 1 (2000) available at <http://suny.yonsei.ac.kr/~jhahm/pdf/emerge.pdf>